Cornell Extension Bulletin 861

Father and Son FARM PARTNERSHIP ARRANGEMENTS

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In Brief

This bulletin is planned to help farm families or persons working with fathers and sons to develop good farm-business arrangements. The presentation is brief and primarily for the use of families who are ready to take definite steps to prepare a specific operating arrangement.

Contents

Farm partnerships are not a "cure-all"!
They must be sound, businesslike arrangements!

Father and Son Farm-Partnership Arrangements

C. A. Bratton

Father-and-son farm-business arrangements are not new. New York State has many farms that have passed from father to son for a century or more. Present-day commercialized farming, however, makes it important for both the father and the son to develop good business-like arrangements.

Father-son arrangements are used as a way to pass a farm business to the younger generation, but farm-business partnerships are not limited to a father and a son. A son-in-law or nephew may be the "junior" member. Some farmers who have no sons take a hired man or neighbor boy into the business with them. The information on the following pages applies equally well to any junior-senior partnership regardless of relationships.

Advantages of a good partnership

In a *good* farm business partnership, both parties (the younger and the older man) benefit by the arrangement. Some of the advantages are:

To the young man (son)

1. The use of capital without a heavy debt load.
2. An opportunity to start in a "going" farm business.
3. A chance to "grow into" the business.
4. Advice of an experienced farmer.
5. Less confinement to farm duties.

To the older man (father)

1. A source of steady, reliable farm help.
2. An opportunity to "let up" gradually (shift responsibility).
3. Protect his income and investment in later years.
4. New ideas and enthusiasm of a young man.
5. Less confinement to farm duties.

Essentials for a "good" partnership

Good partnerships do not "just happen." Certain basic principles must be followed. Two groups of essentials must be considered: (1) personal characteristics and (2) farm-business characteristics.

Personal characteristics

1. Ability to work with other people.
2. Respect for partner (father for son; son for father).
3. Willingness to "give and take."
4. Good business and work habits.
5. Wives informed and interested.
6. Confidence in farm partnerships.

Farm-business characteristics

1. Adequate income for two families (size of business).
2. Separate living quarters for two families.
3. Management shared by both partners.
4. Income shared on the basis of what each contributes.
5. A workable plan for handling records and finances.
6. A definite agreement (preferably written).

If these essentials are not present in the situation under consideration, one should *go slow* or look for some other arrangement. Personal characteristics are extremely important and are difficult to change. The farm-business characteristics usually can be adjusted if the essentials are lacking, but plans for the adjustments should be made before starting the partnership.

How to plan an arrangement

Good farm-business arrangements are not developed in a hurry, nor are they difficult. Many things must be considered and many mutual decisions must be made. It is an important arrangement and is worthy of both time and careful consideration.

There is *no* ONE formula for farm-business arrangements. Just as no two farms are exactly alike, so no two business arrangements are alike. The agreement must fit the parties concerned and fit the particular farm business.

One may get suggestions from other families or from bulletins on this subject. The *Father-and-Son Farm-Business Agreement* form on page 10 serves as a guide in actually writing an agreement. It will need to be altered, however, to fit a specific situation.

An outside party, such as the county agricultural agent, the agriculture teacher, a banker or lawyer, can offer helpful suggestions, but the parties concerned have to decide on the exact arrangement. Father, mother, son, and son's wife should discuss the whole arrangement, decide on an agreement, and then put the agreement in written form.

How to determine the partners' contributions

The problem arises of how to determine the relative contributions of each partner. This can be done by determining what it would cost the business to hire or pay for the contributions made by each party. Since capital and labor are the main contributions, present wage and interest rates are usually used.

In working out business arrangements, the parties may decide to share the income in proportion to each partner's contribution. Sometimes the difference between the receipts and expenses are divided on this basis. In others, the net profits, after paying wages to each partner and paying an interest allowance for the money used, is shared on this basis.

An illustration where the father owns the farm, equipment, and one-half the livestock follows:

Item contributed	Contributions for the year		
	Father	*Son*	*Total*
Investment in land and buildings $10,000 at 5 per cent	$500	$ —	$500
Investment in equipment $8,000 at 5 per cent	$400	$ —	$400
Investment in livestock $12,000 at 5 per cent	$300	$300	$600
Labor, 12 months at $125 per month	$1500	$1500	$3000
Total	$2700	$1800	$4500
Percentage contributed	60	40	100

In this example, contributions are at the ratio of 60 per cent by the father and 40 per cent by the son. Consequently in this arrangement, the income might be split 3/5 to the father and 2/5 to the son.

Figuring the contributions of each party helps to give a clear picture of what each is putting into the business. It also serves as a useful step in arriving at a better understanding of the partnership agreement.

Types of farm-business arrangements

Of the many variations in father-son business arrangements, three general plans with examples are outlined on the following pages. These may serve as a starting point in any discussion of an arrangement for the farm business. These examples, however, are merely guides for discussion and are not given as specific plans to follow.

Plan 1. Son shares farm profits

The father furnishes all land and buildings, livestock and machinery. The son receives a guaranteed wage of $100 a month plus a 25 per cent share in the calculated farm profits. (Methods of calculating farm profits must be definitely agreed upon at the start.)

Example:

Cash farm receipts	$15,600	Cash farm expenses	$ 8,700
Increase in inventory	300	Son's guaranteed wage	1,200
Total receipts	$15,900	Interest on capital at 5%	1,500
Total expenses	11,400	*Total expenses*	$11,400
Calculated farm profits	$ 4,500		

	Son	*Father*	
Wages drawn	$ 1,200	$ —	
Share of farm profits	1,125	3,375	
Interest on capital	—	1,500	
Increase in inventory	—		($300 included in the $3375 above)
Total	$ 2,325	$4,875	

This is a simple farm-business arrangement. It might be considered as a profit-sharing method of paying the son's wages. With this arrangement, the son does not acquire an equity in the business. On the other hand there is an incentive for him to do a good job with the entire farm business since he gets a share of all farm profits.

A simple arrangement of this type is sometimes used as a first step toward a partnership. It can be used as a test arrangement. Termination of an arrangement of this type is easy since there is no jointly owned property.

Plan 2. Son shares farm profits and grows into the business

The father furnishes all land and buildings, livestock and machinery at the beginning of the arrangement. The son owns a half interest in all young stock raised and in new machinery purchased after the arrangement begins. The father receives receipts from the sale of original livestock or machinery. The calculated farm profits are shared 1/3 to son, 2/3 to father.

Example:

Cash farm receipts (excluding $700 from sale of cows)	$14,900
Total expenses	10,200
Calculated farm profits	$ 4,700

Cash farm expenses	$ 8,700
Interest on capital at 5%	1,500
Total expenses	$10,200

	Son	*Father*
Share of farm profits	$ 1,567	$3,133
Sale of original cows	—	700
Interest on capital	25	1,475
Increase in inventory	600	—300
Total	$2,192	$5,008

Some young men are reluctant to assume the size debt load necessary to buy a half interest in the livestock and machinery used in operating the farm business. This plan offers these individuals a way to work into the business without taking on a debt. The son's equity in the business under this plan grows as young stock is raised and new machinery is purchased.

This arrangement has the limitation of not being clear-cut in ownership. There is always the question of which animals or which machines are owned jointly. A good inventory showing ownership is especially important with this arrangement.

Under this plan there is the problem of how to handle the depreciation on the original livestock and machinery. Sometimes a set depreciation charge is paid to the father from the business. Changes in the inventory values of the father's original items can be used to make this adjustment. Others ignore the depreciation feature which means the father stands this cost.

A sizeable portion of the son's income under this plan is in his growing inventory.

Plan 3. Son owns half of livestock and machinery

The father owns the land and buildings; the son and father own livestock and machinery on a 50–50 basis. Each party draws a wage of $125 a month. Each party receives 5 per cent interest on his capital investment. Calculated farm profits are shared 50–50.

Example:

Cash farm receipts	$15,600	Cash farm expenses	$ 8,700
Total expenses	13,200	Wages drawn	3,000
		Interest on capital at 5%	1,500
Calculated farm profits	$ 2,400	*Total expenses*	$13,200

	Son	*Father*
Wages drawn	$1,500	$1,500
Share of farm profit	1,200	1,200
Interest on capital at 5%	500	1,000
Increase in inventory	150	150
Total	$3,350	$3,850

Joint ownership of the personal property used in the farm business makes this arrangement clear-cut and businesslike. There is no problem about the ownership of individual animals or pieces of equipment. The son is a full partner from the start. This is probably the easiest plan to understand and to keep straight financially.

Families using this plan must arrive at a reasonable figure as a basis for the son to buy a half interest. Many families mutually agree upon a value or price. Some families hire an appraiser to place a value on all the personal property. In any case it is important that a reasanable price be used.

Financing the purchase of the son's half interest can be a problem. A few sons have worked off the farm and have available capital with which to buy into the business. Some borrow from credit agencies. A common procedure, however, is for the son to give the father an interest-bearing note for the unpaid balance of his equity, with provisions to repay the note as time passes.

After reviewing the three general plans the partners must decide on the one that might work best for their situation. Then discuss the changes in the general plan that would need to be made, and talk over in detail how these things would apply to this business. There will be some differences of opinion, but these can usually be resolved if talked over fully. Eventually a likely arrangement for this proposed partnership can be determined.

Test proposed financial arrangement

After a decision has been made on the general financial arrangements, the plan should be tested. Based on last year's business and the plans for the coming year, each party can figure how he will fare under the proposed plan. If it is not satisfactory, the arrangements should be changed until it does fit.

Frequently the farm-account records for the past year can be helpful in testing a proposed plan. The proposed sharing arrangement can be applied to the actual receipts and expenses as recorded in the farm cash account. The returns that each partner would have received from last year's operations can then be figured.

An actual test of a proposed arrangement may show that the financial division does not work out as had first been considered. It is worthwhile to check and make any needed changes before the plan is put into use.

Guide in drafting agreement

The farm-business-agreement form on pages 10 to 13 is merely a guide to help plan and draft an agreement for a family. The sections should be changed to fit the specific situation; omitting those sections that do not apply and adding others to take care of special items in the business.

Each partner should go over each provision in the agreement carefully, and review what each party's understanding is of the various items. A thorough discussion will bring out points on which there is need for clarification. Time spent at this stage in clarifying items will help to avoid misunderstandings later.

After the provisions have been discussed fully, a rough draft of the agreement should be prepared. A few days later, each should go over the agreement as written out in the first draft. In doing this, points may be discovered that were omitted on the first draft. It may be helpful to go over this two or three times before it is put in final form.

Legal counsel

An attorney can advise on the legal phases of the agreement. Once an arrangement is decided upon, it is suggested that the family go to a lawyer who understands farming and have him put the agreement in proper legal form.

FATHER-AND-SON FARM-BUSINESS AGREEMENT

This agreement made this ______ day of ________________, 19____,

by and between ______________________________________, the father,

and ______________________________________, the son.

Witnesseth:

ARTICLE I. PURPOSE

The aforesaid father and son hereby enter into this agreement for the purpose of operating a farm business on the following described real estate:

____

situated in the Town of ____________________________, in the County of

_________________________, in the State of __________________________,

and on any other land which said parties may agree to rent.

ARTICLE II. PERIOD COVERED

This agreement is to start __________________, __________________,

19_____, to continue from year to year on the terms herein stated until this agreement is dissolved or until it is replaced by another written agreement. The agreement may be dissolved by either party serving notice on the other at least ________ months prior to the end of the year on which dissolution is desired.

ARTICLE III. CONTRIBUTIONS

A. *Labor*

Each party shall contribute his entire labor and management to the farm business.

B. *Real Estate*

Father to furnish the land and buildings as described in Article I and all material and labor for any capital improvements of the same.

C. *Personal Property*

Father and son each to furnish one-half of all livestock. Father to furnish all power equipment, machinery and tools used in conducting the farm business. At the beginning of the agreement the son shall purchase a half interest in all feeds and supplies on hand that will be used in the business.

ARTICLE IV. MANAGEMENT

A. General operating plans shall be discussed and agreed upon at the beginning of each year. Adjustments that appear desirable during the year shall be made after being agreed upon by both parties.

B. All purchases involving more than ______________ dollars shall be mutually agreed upon.

C. A joint checking account shall be carried with the ______________ ______________ Bank of ______________________. Checks shall be signed by either party. Each party shall contribute $______________ to open the account.

D. The following financial records are to be kept:

1. A complete inventory showing ownership and value of all property used in the farm business, shall be made at the time the agreement starts and at the end of each year thereafter. All values shall be agreed upon by both parties.
2. A current record of all farm receipts and expenses, including allowances made to each party, shall be kept by ______________________.

ARTICLE V. RECEIPTS AND EXPENSES

Profits for the year shall be calculated as indicated in the following table:

Receipts:		
Cash receipts	$..............	
Increase in inventory value of property not jointly owned	....	
Total receipts		$..............
Expenses:		
Cash expenses	$..............	
Interest on debts	....	
Son's wage allowance	....	
Father's wage allowance	....	
Interest on investment	....	
Decrease in inventory value of property not jointly owned	....	
Total expenses		$..............
Profit (total receipts less total expenses)		$..............

Explanation of Items

A. *Cash receipts* shall include all income from the sale of crops, livestock, and livestock products; all income from work off the farm by either party; and any miscellaneous cash income of the farm business.

B. *Cash expenses* of the farm business shall include fertilizer and lime; seed; purchased feed; spray materials; wages and cash cost of board for hired labor; real-estate taxes; insurance; rent for additional land; purchases of livestock; purchases of new equipment; operating expenses of all equipment and tools; repairs and replacements necessary to keep buildings, fences, wells and drains in good condition; machine work hired; electric lights and power; and such other expenses mutually agreed necessary for the operation of the farm business.

C. *Interest on debts* is the amount of interest payable by the father or by the father and son on outstanding debts on property used in the farm business.

D. *The wage allowance* for each party shall be paid monthly. The amount of these wage allowances shall be agreed upon at the beginning of each year.

E. Each party shall receive *interest* at ________ per cent on his investment in the business. The investment of each party is the total value of real estate, livestock, and equipment at the beginning of the year as shown in the inventory, less the debts for which interest is allowed in Section C above.

F. *Increases or decreases in inventory of property not jointly owned* should *not* include changes in value due to general changes in prices. This should include only changes due to more or less property or to better or poorer condition of the property. If the property has increased in value, the party who owns it owes the amount of the increase to the business. If the property has decreased in value, the business owes the owner the amount of the decrease.

ARTICLE VI. FINANCIAL SETTLEMENT

A complete financial settlement shall be made at the end of each year. Each party shall receive the calculated interest on his investment, reimbursement for any decrease in inventory in his personal property, and one-half of the profits calculated in Article V. A balance mutually agreed upon shall be left in the joint checking account to be used in starting the business for the next year.

ARTICLE VII. LIVING ARRANGEMENTS

Living arrangements are to be provided for both father and son and their families. If an additional house is rented for either party, the rental cost shall be shared the same as other farm operating expenses. If either party furnishes the board of the other, the party so furnished shall pay to the one providing the board ________ dollars per month as his share of the cash cost of such board.

ARICLE VIII. DIVISION OF JOINTLY-OWNED PROPERTY

If either party decides to withdraw from the business or in case of the death of either party, the party remaining shall have the option to buy the other party's share of jointly-owned property at the inventory value or any other values mutually agreed upon.

ARTICLE IX. ______________________________

It is further agreed that ______________________________________

____

ARTICLE X. REVIEW OF AGREEMENT

This agreement shall be reviewed each year at the time of the financial settlement. Any desired changes shall be made in the agreement at that time.

ARTICLE XI. ARBITRATION

If any matter pertaining to the farm business cannot be settled by mutual agreement, that matter shall be submitted to one disinterested person agreeable to both.

____

JOHN DOE, *Father*

____

MARY DOE, *Mother*

____

ROBERT DOE, *Son*

____

BETTY DOE, *Son's wife*

Some general suggestions

Many decisions confront a family in the process of developing a good farm-business arrangement. A few general suggestions, based on the author's experience in working with families on farm partnerships are offered as a help in making these decisions.

Partners must get along

The individuals in a partnership must be able to work together and get along. This calls for a willingness to give and take and the ability to talk over differences and to come to mutual decisions. These traits should exist when the partnership is formed. A written partnership agreement does not "make" the partners get along. If they didn't get along before, usually they don't get along after the agreement is signed.

Wives are an important part

The mother and the son's wife can play a big part in making the partnership successful. They must be interested in, and should be familiar with, the business arrangements. It is desirable to have the wives help in the development and the writing of the agreement.

Other family members concerned

Brothers and sisters have an interest in the home-farm situation. They have a financial stake in their father's estate. Troubles can be avoided many times if all members of the family are kept informed on the general features of the father-son partnership.

Brothers in a partnership

Two or more sons can be included successfully in a father-son partnership, but problems tend to increase with the number of partners. The attitudes of the brothers and their wives toward each other is extremely important. When the partnership includes two or more sons, it is well to consider ways for the business to be divided upon the death of the father or if the time should come when each brother wants a business of his own.

Be businesslike within the family

Father-and-son farm partnerships are business arrangements. Therefore, it is important that financial affairs be handled in a businesslike manner. A common cause of troubles and misunderstandings in partnerships is the lack of clear-cut, businesslike procedures. A good rule is to handle financial matters of the partnership the same as they would be if the partners were nonrelated.

Share in entire business

Projects are used effectively as an incentive for young boys on the farm. Some families continue the projects after the son finishes school. If the son is to continue on the farm and work into a partnership with his father, there are distinct advantages to shifting from the project basis to an arrangement involving the entire farm business.

A farm checking account

A common arrangement for handling partnership finances is the farm checking account. This is usally a joint account with both partners able to sign checks. All farm receipts are deposited in the account and all farm expenses paid from it. The partners draw a monthly allowance for their personal and living expenses. Businesslike procedures are important here. This account should be used strictly for partnership transactions.

Keep arrangements simple

Simple, definite arrangements are easier to understand and present fewer problems than complicated ones. A straight 50-50 ownership arrangement for livestock and machinery with the father given an interest allowance for his real-estate investment and all other items shared 50-50 has much to be said for it. There is *no one* best arrangement but in general avoid complicated and unusual features.

Written agreements

A written agreement in itself will not make a partnership work but it can help. Putting the agreement in writing causes the partners to think through the details of the arrangement and to arrive at definite understandings. This may prevent troubles later. It also serves as a record of what was agreed upon in case of a death or if someone forgets.

Review the arrangement regularly

Conditions in any family or business change over time. All of these changes cannot be anticipated in advance. Consequently it is important that the arrangement be reviewed each year. When conditions change, the arrangement should be adjusted accordingly.

Transfer of farm ownership

Good partnerships are progressive. The first stage usually makes it possible for the son to acquire ownership in the personal property (livestock and machinery). Later, plans should be made for the eventual transfer of ownership of the real estate. Information on this may be found in Cornell Extension Bulletin 892 and Experiment Station Bulletin 901.

It's up to You . . .

NO PARTNERSHIP

OR PARTNERSHIP

A publication of the
New York State College of Agriculture,
a unit of the State University of New York,
at Cornell University

Revised April 1955

Published by the New York State College of Agriculture at Cornell University, Ithaca, New York M. C. Bond, Director of Extension. This bulletin is published and distributed in furtherance of the purposes provided for in the Acts of Congress of May 8 and June 30, 1914.